

Central Intelligence Agency

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Australia's Troubled Economy: Hawke's Political Approach

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Summary

Prime Minister Hawke's foray into consensus politics could change the course of economic policymaking in Australia. Hawke's recent economic summit was a major political success to the extent that he brought business and labor together and convinced them his government would have to back away from campaign promises to pursue expansionary fiscal policies and maintain real wages. The consensus is fragile, however, and a breakdown, if it comes, would be from Hawke's own constituency, organized labor.

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Hawke's Economic Education

The dismal economic situation inherited by the Hawke government continues to worsen. Unemployment in April hit 10.3 percent--up nearly one percentage point since Hawke assumed office last March and up two percentage points in the last six months. We expect that May's unemployment rate will show a further increase when it is announced in early June, a few days before Hawke's arrival in Washington. Canberra now concedes that the jobless rate will likely continue to increase well into 1984 and probably reach 12 percent.

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Manufacturing is in a deep slump with production running 15 percent below year earlier levels. Continued high interest rates and rapid wage growth--15 percent in 1982--are primarily responsible for the poor economic performance. We expect the economy to bottom out this year with national output falling by nearly one percent. The bleak outlook has left business

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investment plans in disarray, and, according to the government, capital investment is expected to fall 26 percent in the fiscal year beginning this July. [redacted] 25X1

The recession and inflation are resulting in a huge increase in the budget deficit, which Canberra expects to more than double to \$7.5 billion in the 1983-84 fiscal year. According to the Australian Treasury, real revenue in 1983-84 will decline for the first time in over a decade, due both to the recession and tax cuts passed by the Fraser administration. At the same time, government expenditures are rising rapidly because nearly 55 percent of outlays are indexed to inflation--which remains stubbornly high at a 9 percent annual rate. According to Finance Minister Dawkins, if Canberra attempts to hold the overall spending increase to 3 percent next year, without touching the indexed categories, all non-indexed components--which include defense and education--would have to be reduced by 2.5 percent. [redacted]

The budget deficit is placing serious constraints on the government's economic options. US Embassy reporting indicates Hawke is clearly concerned about the size of the deficit, and fears that the expansionary policies he advocated during the campaign could push interest rates to levels that would strangle any domestic economic recovery. As such, the interim budget announced by the Hawke government in mid-May is deflationary. A \$500 million jobs program will be more than offset by nearly \$900 million in tax hikes and spending cuts in other programs. We believe the budget Hawke will present in August for the new fiscal year will include further spending cuts and tax increases. The Fraser government's proposals for a \$475 million Darwin to Alice Springs rail link and an \$300 million expanded water resources development program are prime candidates for the ax. [redacted] 25X1

The Economic Summit: An Attempt at Consensus Politics

In an attempt to deal with the mounting economic problems, Hawke followed through on his campaign promise to hold an economic summit of government, union, and business officials. In our judgment, the summit was a first step toward a major change in the way economic policy is formulated in Australia. Even at this early stage of his tenure, we believe that preparing economic policy options under Hawke will no longer be the preserve of a few senior bureaucrats and a select group of outside advisors. Rather, Hawke wants many interest groups to have an input in policy formulation (see Appendix). At the same time, we believe the Prime Minister has staked his personal reputation and his government's on an end to the confrontation that has been a feature of domestic labor relations for many years. [redacted] 25X1

According to the US Embassy, the summit was a political success for Hawke, and the fact that he brought together business and labor at all was a major accomplishment. Hawke effectively used the summit to lower expectations of an early economic recovery or any substantial reduction in unemployment. Coupled with his personal friendship with many corporate and business leaders, he was able to obtain concessions from both business and labor. The Australian Council of Trade Unions (ACTU), which Hawke headed for 11 years, agreed that his campaign promise to maintain real wages was not appropriate with unemployment above 10 percent, and conceded that taxes might have to be increased if job creation programs are launched. For its part, business leaders agreed to return to a system of centralized wage indexation, under which wages throughout the economy would lag behind inflation, which would mean a decline in real wages. 25X1

Nonetheless, the summit failed to deal completely with the issue of wages. Business and organized labor still have significant differences over the indexation method and the length of the current wage freeze, which is scheduled to end on 30 June. The summit left these politically tough decisions to the Australian Arbitration Commission which meets in late June. Organized labor is pushing for an immediate end to the freeze and full indexation thereafter to keep pace with inflation. Business, however, is lobbying for an extension of the wage freeze. We believe Hawke will attempt to compromise by accepting full indexation beginning in 1984 in return for an extension of the freeze to at least September 1983 and possibly to the end of the year. 25X1

Hawke and the Unions

Recent remarks by Treasury Minister Paul Keating indicate Canberra recognizes that wage inflation will be the most crucial determinant of the economy's performance over the next several years. Nonetheless, union criticism of the government's wage restraint policy is growing and could sour the consensus reached at the summit. The 29,000-member Building Laborers' Federation, a radical union with a maverick reputation, is currently pushing to secure a \$3.50 an hour pay rise and a shorter work week. According to the US Embassy, resolution of this problem remains a major test of the viability of Hawke's approach to economic policy. Hawke has warned the union that it might be expelled from the ACTU if it persists with their demands. 25X1

Other unions are also pushing for wage increases. The Metal Workers' Union--Australia's largest--is arguing that the 9.2 percent "lost" during the wage freeze must be made up. Although the ACTU agreed at the summit that no catchup increase would be granted when the freeze ended, the ACTU Executive Committee recently decided to change its position and seek full cost-of-

living increases for 1983. The large Transport Workers Union, whose previous strikes have crippled air and land travel, is persisting in its demand for the pay rise agreed to before the wage freeze was imposed last December. [redacted]

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We believe Hawke's \$500 million jobs program and the recent tightening of immigration quotas are partly an attempt to mollify union criticisms. In our judgment, however, Hawke faces a tough challenge keeping labor in line despite his long career in and close connections with the trade union movement. Both sides seem determined to win, and a collision between Hawke and certain factions of the labor movement seems inevitable. [redacted]

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Other Reactions

Business and government bureaucrats are also reacting to the new shape of policy making. Corporate leaders are convinced they were upstaged by the ACTU at the summit, according to the US Embassy. After seven years of the Fraser government speaking on its behalf, business representatives came to the summit poorly prepared and disorganized, and they were on the defensive from the start according to the US Embassy. Because of their poor performance, business leaders have decided to establish an association to represent manufacturing, service, and rural industry in future tripartite talks. [redacted]

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We believe that senior level bureaucrats, who helped shape and implement policy in the previous government, are also concerned about a loss of influence. They reluctantly furnished the summit with information on planning and forecasts which had previously been reserved for the inner sanctum of government. In addition, press reports indicate many senior bureaucrats are unconvinced that Labor's price and incomes policy will be successful. [redacted]

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Points to Ponder

In our judgment, Hawke has a good chance to change the face of domestic industrial relations. He enjoys greater personal rapport with the Australian public than any recent Prime Minister. His experience as an industrial "fireman" arriving on the scene to solve crippling strikes, at which he seldom failed, has apparently convinced him that this can be extended to the national scene. The danger is that further economic deterioration could cause even moderate labor unions to reject Hawke's consensus approach and return to confrontational negotiations. [redacted]

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In any case, continued economic stagnation will likely cause trade tensions with other countries, including the United States. Both industry and unions recently called on the Hawke government to provide more import protection for the metal

industry to preserve jobs. Since February 1982, employment of metal workers has declined by more than 80,000. In addition, we believe Canberra will approve the request of BHP--the country's largest company and leading steel producer--for increased tariffs on imported steel to assure the company of at least 85 percent of the Australian steel market. According to the US Embassy, South Korea recently warned the Australian government that Seoul might retaliate if it is denied access to export markets in Australia. [redacted] 25X1

Frictions with the Japanese over resources may also increase. The Australian coal industry was recently stunned by 15-20 percent price cuts forced on them by Japanese steel firms because of the depressed international coal market. Japanese firms are also pressuring Australian iron ore suppliers for similar price cuts. Canberra's frustration was revealed recently when Deputy Prime Minister Bowen publicly lashed out at the Japanese for exploiting Australia in the resource field. [redacted] 25X1

The economy will also affect Canberra's foreign investment policy, details of which will be announced in mid-June. We believe Hawke will tighten up exceptions to the 50 percent Australian equity requirement and press for maximum Australian participation--foreign ownership will be limited to the share that cannot be obtained from domestic sources. The Foreign Investment Review Board, in our judgment, has already adopted a tougher attitude on a number of investment proposals made since the election, including rejecting proposals by a US firm to acquire full ownership of a leading Australian distributor of industrial plastics and a South Korean bid for 25 percent participation in a pipeline project. [redacted] 25X1

In an effort to calm jitters at home and abroad about the government's foreign investment policy, Keating recently stated in Parliament that while an appropriate balance between domestic and foreign investment is necessary, overseas capital has accelerated Australia's economic development and presumably continues to be welcome within government guidelines. According to the US Embassy, Keating will reaffirm this approach when he addresses representatives of the New York financial community during Hawke's visit. [redacted] 25X1

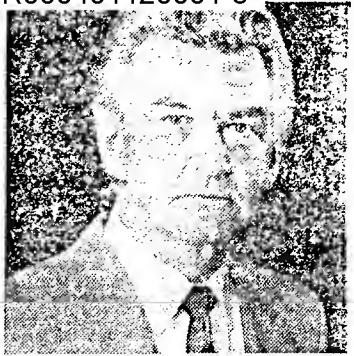
Looking Ahead

In the short run, Hawke's options for stimulating the economy are severely limited by the huge prospective budget deficit. Moreover, Australia cannot count on resource investments--the engine of growth in the 1970s--for economic recovery. We believe soft oil prices will continue to dampen investment in domestic energy resources such as coal, oil, and natural gas, and depressed steel demand abroad will have the same effect on investment in the iron ore sector. Domestic economic

recovery depends on sustained economic growth in the industrialized West and the firming of commodity prices. As such, the Australian economy may lag as much as 12 months behind recovery in the United States, Japan, and Western Europe, because the recession began later in Australia than in these other 25X1 countries.

In the medium term, if Hawke is successful in breaking the wage-price spiral, it would help lay the foundation for improving the international competitiveness of Australian industry, in our judgment. Australian exports will have a difficult time competing in world markets should domestic inflation remain significantly above the world average. As it is, any competitive advantage gained by Canberra's recent 10 percent devaluation of the dollar is being eroded by Australia's high inflation relative to its major trading partners. We also believe that reducing protectionism will be required to restore competitiveness. At present, the Australian economy is one of the most protected markets in the OCED, according to a US banking study. In our judgment, however, it will be difficult for the Hawke government to reduce tariffs and ease other protectionist measures because of political pressures from both unions and business.

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The next Summit.

15 million
people
are
invited.

The first Economic Summit in Canberra brought together 100 leaders of various groups in our community.

It set the directions that Australia will take in the future. Agreement was reached on how to tackle a range of serious problems. Such as creating jobs, boosting the housing industry, and creating a prices and incomes policy that is fair to everyone.

It was an important event. However the next Summit is the big one. Its aim is to turn all of the talking into action.

The next Summit is not an event. It is an attitude. A state of mind.

Every Australian must come to realise that we're all in this together. The severe economic problems that face our country are our problems.

If they are to be fixed, then we all must play our part in fixing them.

It will mean an attitude of co-operation, of working together.

It may mean certain sacrifices. But so long as the sacrifices are shared fairly, it will be for the good of all Australians.

Very soon the government will announce the first of its economic plans, stemming from the Canberra Summit. On that day every Australian will be shown how they can contribute to Australia's economic recovery.

With your co-operation, the next Summit will start that day.



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